IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In Re ENRON CORPORATION SECURITIES, DERIVATIVE & "ERISA" LITIGATION	§ § §	MDL 1446
MARK NEWBY, et al., Plaintiffs	§ § § §	
vs.	§ §	Civil Action No. H-01-03624 And Consolidated Cases
ENRON CORPORATION, et al., Defendants	§ § §	(including No. H-03-5528)

MOTION TO DISMISS AND MEMORANDUM IN SUPPORT THEREOF OF DEFENDANTS:

THE ROYAL BANK OF SCOTLAND GROUP PLC,
THE ROYAL BANK OF SCOTLAND PLC,
NATIONAL WESTMINSTER BANK PLC,
GREENWICH NATWEST STRUCTURED FINANCE, INC.,
GREENWICH NATWEST LTD.,
AND CAMPSIE, LTD.

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INTRODUCTION

Pursuant to Federal Rule of Civil Procedure 12(b)(6), defendants The Royal Bank of Scotland Group plc, The Royal Bank of Scotland plc, National Westminster Bank Plc, Greenwich NatWest Structured Finance, Inc., Greenwich NatWest Ltd., and Campsie, Ltd. (collectively, "RBSG") move to dismiss all claims asserted against them in the December 2, 2003 Complaint ("12/03 Complaint"). A supporting memorandum follows.

PROCEDURAL BACKGROUND

The first lawsuit commencing this now-consolidated action, *Newby v. Enron Corp. et al.*, Civil Action No. H-01-3624, was filed on October 22, 2001. The suit initially named as defendants Enron and certain of its officers and directors. Six months later, on April 8, 2002, after the appointment of lead plaintiff and lead counsel, Plaintiffs filed their Consolidated Complaint, naming several financial institutions (among others) as defendants for the first time, but not naming RBSG. On December 20, 2002, this Court granted in part and denied in part the defendants' motions to dismiss the Consolidated Complaint, with leave to amend. The new pleading -- the First Amended Consolidated Complaint -- arrived on May 14, 2003, bearing several new defendants, but again not RBSG. RBSG was not brought in until yet another six months had passed. The December 2, 2003 Complaint first named RBSG and was, under this Court's standing order of December 12, 2001, promptly acknowledged as part of this action and consolidated with it. Plaintiffs plead a single count against RBSG for violation of Sections 10(b) and 20(a) and Rule 10b-5.

FACTUAL SUMMARY

RBSG is a financial services group based in the United Kingdom. One of its current constituent banks, National Westminster Bank Plc ("NatWest"), was a separate, independent

entity until acquired by RBSG in March 2000, joining The Royal Bank of Scotland plc ("RBS") as a constituent bank. According to the 12/03 Complaint, RBSG[1] (defined to encompass pre-merger NatWest) had commercial lending relationships with Enron and also was a counterparty to financial transactions with Enron. Four of these transactions (one having three subparts) are cited as prompting RBSG's inclusion in the litigation: the Sutton Bridge Transaction (pre-merger NatWest); the LJM1/Rhythms Hedge Transaction (pre-merger NatWest); a December 1999 commodities transaction, known by some as the "Nixon Prepay" Transaction (pre-merger RBS); and the ETOL I, II and III Transactions (post-merger RBSG). These transactions were, say Plaintiffs, reported incorrectly by Enron for financial purposes within the much broader scope and larger size of its published financial statements, helping to make those statements fraudulent.

RBSG is not accused of having been a significant participant in the Enron debacle. Plaintiffs do not assert that RBSG published analysts' reports or other research on Enron securities. Plaintiffs do not allege that RBSG made or endorsed any public statements of any sort about Enron's financial situation or prospects. Plaintiffs do not plead that RBSG provided any legal or accounting advice to Enron. Plaintiffs do not identify RBSG as an equity participant in the large, fluid LJM2 partnership. Plaintiffs nonetheless seek to recover from RBSG for having violated the federal securities laws.

ARGUMENT

Plaintiffs did not name RBSG until more than two years after Enron had "shocked the markets" by announcing $1 billion in charges and a $1.2 billion reduction in shareholders' equity

[1] The Complaint uses the designation "RBS" to encompass all the affiliated defendants. We use the designation "RBSG," so as to avoid any confusion with The Royal Bank of Scotland plc.

(Am. Compl. ¶ 61[2]), and more than two years after this proceeding had been commenced. Plaintiffs chose not to sue RBSG until December 2, 2003, even though RBSG's connections with Enron, and with transactions assertedly associated with Enron's later collapse, were known well before Enron declared bankruptcy on December 2, 2001, and even though Lead Plaintiffs themselves acknowledged their basis for filing suit against RBSG in a letter dated October 3, 2002.

Plaintiffs' claims are time-barred. First, the claims are barred by the *Lampf* one-year limitations period and three-year repose period. Plaintiffs were on notice of the alleged violations more than a year before they filed against RBSG. Accordingly, the applicable one-year statute of limitations bars all claims. In addition, most of Plaintiffs' claims are time-barred by the three-year statute of repose. With the exception of the ETOL II and III transactions, all of the transactions that make up the alleged violations are pleaded to have occurred before December 2, 2000, and thus more than three years before the filing of the 12/03 Complaint.

Second, Plaintiffs' claims are barred even if the Sarbanes-Oxley limitations period applies. The claims based on the Sutton Bridge and LJM1/Rhythms Hedge transactions, which are alleged to have occurred in June 1999, were barred by the three-year repose period before Sarbanes-Oxley became effective, and Sarbanes-Oxley did not resurrect those stale claims. Additionally, Plaintiffs were on inquiry notice of the alleged fraud by Enron, and of RBSG's alleged connection to that fraud, more than two years before Plaintiffs brought any claims against RBSG. Accordingly, their claims are barred even under Sarbanes-Oxley's two-year limitations period.

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[2] Citations to the Amended Complaint ("Am. Compl. ¶ __") refer to Plaintiffs' First Amended Consolidated Complaint, filed May 14, 2003. Citations to the Complaint ("Compl. ¶ __") refer to the December 2, 2003 pleading bringing in RBSG.

Apart from limitations issues, Plaintiffs also fail to allege that RBSG was a primary violator of the securities laws, and they fail to allege loss causation against RBSG. The Section 20(a) claim fails because the 12/03 Complaint does not properly plead a claim under Section 10(b). RBSG should be dismissed from this action.

I. PLAINTIFFS' CLAIMS ARE BARRED BY THE APPLICABLE *LAMPF* STATUTES OF LIMITATIONS AND REPOSE.

The 12/03 Complaint purports to state a securities class action "on behalf of purchasers of Enron Corporation's . . . publicly traded equity and debt securities between December 2, 1998 and November 27, 2001." (Compl. ¶ 1.) As this Court has ruled, the one-year limitations period and three-year repose period established by the Supreme Court in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991), apply to the claims in the *Newby* class litigation. *See In re Enron Sec., Derivative & ERISA Litig.*, 258 F. Supp. 2d 576, 601 n.20 (S.D. Tex. 2003).[3] Plaintiffs have implicitly conceded that this case is a continuation of *Newby* by failing to file a motion to appoint lead counsel and lead plaintiff or otherwise to follow the procedures needed to initiate a new securities fraud class action. In fact, in the 12/03 Complaint the Regents and counsel characterize themselves as playing their respective *Newby* roles: "Lead Plaintiff" (Compl. ¶ 4) and "Lead Counsel for Plaintiffs" (Compl. p. 20, Signature Block).

A. PLAINTIFFS' CLAIMS ARE BARRED BY THE *LAMPF* ONE-YEAR STATUTE OF LIMITATIONS.

RBSG was first named as a defendant on December 2, 2003. Claims based on violations that were either known or knowable before December 2, 2002, are thus barred by the applicable one-year statute of limitations.

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[3] *See also* Reply Mem. of Law in Further Support of Defendant Bank of America Corporation and Banc of America Securities LLC's Mot. to Dismiss the First Am. Consolidated Compl., at 4-8 (filed July 31, 2003, Docket No. 1605); Reply Mem. of Law in Support of Mots. of Defendants Citigroup Inc. [*et al.*] Limited to Dismiss Certain Claims Asserted in Pls.' First Am. Consolidated Compl., at 17-22 (filed July 31, 2003, Docket No. 1599); and Bank Defendants' Mem. of Law in Support of Their Mot. to Dismiss on Statute of Limitations Grounds, at 29-32 (filed Nov. 14, 2003 under *Washington State Investment Board* caption, Docket No. 76).

On October 3, 2002, counsel for Lead Plaintiffs, the Regents of the University of California, sent a letter to RBS stating that "[o]ur continuing investigation reveals a basis for naming Royal Bank of Scotland, Plc., and National Westminster Bank, Plc. ('NatWest'), as defendants." *See* attached Exhibit A.[4] Plaintiffs were thus actually aware of possible claims against RBSG no later than October 2002. That Plaintiffs were on inquiry notice long before December 2, 2002, is also demonstrated by Enron's bankruptcy on December 2, 2001, by public disclosures in February 2002 by the Special Investigative Committee of the Enron Board of Directors of allegedly improper transactions,[5] and by the avalanche of news articles detailing every step of the Enron collapse. Nonetheless, Plaintiffs failed to file the 12/03 Complaint against RBSG for two years after Enron's bankruptcy and more than a year after the letter from Plaintiffs' counsel. Accordingly, all of the claims in the 12/03 Complaint against RBSG are barred by the applicable one-year limitations period.

B. PLAINTIFFS' CLAIMS BASED ON THE SUTTON BRIDGE, LJM1/RHYTHMS HEDGE, NIXON PREPAY, AND ETOL I TRANSACTIONS, WHICH OCCURRED BEFORE DECEMBER 2, 2000, ARE BARRED BY THE *LAMPF* THREE-YEAR STATUTE OF REPOSE.

No matter when Plaintiffs were on inquiry notice of the claims against RBSG, all claims based on violations occurring before December 2, 2000, are barred by the applicable three-year statute of repose. A period of repose, such as the three-year limitation for securities claims under *Lampf*, is "an absolute bar" that cannot be tolled. *See Corwin v. Marney, Orton Inv.*, 788 F.2d

[4] In that letter, Plaintiffs requested that RBS and NatWest each sign a separate agreement tolling the limitations period from October 10, 2002 until October 3, 2003. While RBS and NatWest did sign these agreements, the agreements by their express terms tolled the limitations periods only in the event that the Regents filed a complaint against or joined RBS and NatWest on or before October 3, 2003. *See* RBS Agreement & NatWest Agreement, attached as Ex. B, at ¶ 1, 5 (both stating that "In the event that, prior to the termination of this Agreement" Lead Plaintiff joins or files suit against RBS/NatWest, a statute of limitations defense "is hereby tolled . . . . This Agreement shall be effective until October 3, 2003 . . . ."). Because the tolling agreements expired two months before Plaintiffs first asserted claims against RBSG, the agreements have no effect on this case.

[5] *See* Form 8-K Current Report, Enron Corp., Exhibit 99.2 (Feb. 7, 2002), attached as Ex. C.

1063, 1066 (5th Cir. 1986). It is thus immaterial when Plaintiffs claim to have discovered their claims. *See Radford v. Gen. Dynamics Corp.*, 151 F.3d 396, 401 (5th Cir. 1998).

The 12/03 Complaint alleges that RBSG participated in a scheme to defraud through involvement in four Enron transactions:

- the LJM1/Rhythms Hedge Transaction;
- the Sutton Bridge FAS 140 Transaction;
- the ETOL I, II and III FAS 140 Transactions; and
- the Nixon Prepay Transaction.

(Compl. ¶ 24.)

For the most part, the 12/03 Complaint itself either does not plead dates on which these alleged securities violations occurred or pleads dates only in the most general terms. Paragraph 35 of the 12/03 Complaint, however, incorporates Appendix E to the Final Report of the court-appointed Enron bankruptcy Examiner. (Compl. ¶ 35.) The more specific dates provided in the Examiner's Report are thus considered part of the allegations in the complaint. *See, e.g., In re Rickel & Assocs., Inc.*, 272 B.R. 74, 83, 91-92 (Bankr. S.D.N.Y. 2002) (bankruptcy Examiner's Report incorporated into later complaint; allegations in Report treated as part of complaint).

Appendix E repeatedly says that the Sutton Bridge FAS 140 transaction closed in June 1999 -- specifically, on June 8, 1999. (Compl., App. E, at 2, 14, 17, 63.) Similarly, Appendix E repeatedly asserts that the LJM1/Rhythms Hedge transaction closed in June 1999. (*Id.* at 14, 17, 42.) Appendix E describes the Nixon Prepay transaction as closing in December 1999 (Compl. ¶ 33 & App. E, at 14, 17, 23, 79), with an extension completed in April 2000 (*id.* at 82). The ETOL I transaction is listed as occurring in November 2000. (*Id.* at 15, 18, 66, 67 ("ETOL I closed on November 1, 2000"), 73). Only the ETOL II and ETOL III transactions are listed as

occurring after December 2, 2000. (*Id.* at 18 (listing ETOL II in March 2001 and ETOL III in June 2001)).

Because the alleged Sutton Bridge, LJM1/Rhythms Hedge, Nixon Prepay, and ETOL I violations occurred more than three years before Plaintiffs filed suit against RBSG (on December 2, 2003), Plaintiffs' claims based on these transaction are barred by the three-year statute of repose. These claims must be dismissed.

II. PLAINTIFFS' CLAIMS ARE BARRED EVEN IN LIGHT OF SARBANES-OXLEY.

A. CLAIMS BASED ON THE SUTTON BRIDGE AND LJM1/RHYTHMS HEDGE TRANSACTIONS, WHICH OCCURRED BEFORE JULY 30, 1999, WERE BARRED BEFORE SARBANES-OXLEY BECAME EFFECTIVE AND WERE NOT RESURRECTED BY THE ACT.

Even if the Court were to apply the Sarbanes-Oxley Act to the claims asserted against RBSG, the claims based on the Sutton Bridge and LJM1/Rhythms Hedge transactions are nonetheless time-barred. As explained in part I.B above, the 12/03 Complaint alleges the Sutton Bridge and LJM1/Rhythms Hedge transactions closed in June 1999. The three-year repose period expired for those claims before July 30, 2002, the effective date of the Sarbanes-Oxley Act, and that Act does not revive previously-expired claims.

1. Section 804(c) of the Sarbanes-Oxley Act Expressly Prohibits the Revival of Time-Barred Claims.

Section 804(c) of the Sarbanes-Oxley Act expressly prohibits the revival of time-barred claims. That section, entitled "NO CREATION OF ACTIONS," states that "[n]othing in this [statute of limitations] section shall create a new, private right to action." *Id.* at § 804(c). To apply the Act retroactively to resuscitate previously time-barred claims would do exactly what the Act prohibits -- create a new, private right of action. *See In re Enterprise Mortgage Acceptance Co. Secs. Litig.*, __ F. Supp. 2d __, No. 1:03-CV-3752, 2003 WL 22955925, at *5

(S.D.N.Y. Nov. 14, 2003) ("This subsection appears to directly conflict with the contention that Section 804 allows for the revival of time-barred claims because the assertion of a claim that was previously barred can be construed as a new, private right of action.").

The Supreme Court has made clear that applying a statute so as to revive a previously moribund claim does in fact create a new, private right of action. In *Hughes Aircraft Co. v. United States ex rel. Schumer*, 520 U.S. 939 (1997), the question was whether a 1986 amendment to the False Claims Act that eliminated a defense to *qui tam* actions -- prior disclosure to the Government -- could be applied to pre-1986 conduct so as to revive respondent's *qui tam* claim. The Court noted that plaintiffs' *qui tam* claim had been "completely barred" before the 1986 amendment. *Id.* at 950. Thus, the Court concluded that giving the 1986 amendment retroactive effect -- just like applying a new statute of limitations to revive time-barred claims -- would create a new cause of action:

> The 1986 amendment would revive [the] action, subjecting [defendant] to previously foreclosed *qui tam* litigation, *much like extending a statute of limitations after the pre-existing period of limitations has expired impermissibly revives a moribund cause of action.* . . . It is simply not the case that, as respondent asserts, the elimination of a prior defense to *qui tam* actions does not 'create a new cause of action' or 'change the substance of the extant cause of action.'

Id. (citation omitted) (emphasis added). Absent an explicit mandate from Congress, the Court refused to apply the 1986 amendment to conduct that occurred before its enactment.

Like the *qui tam* claim in *Hughes,* Plaintiffs' securities fraud claims here were "completely barred" before the Act became effective. *Id.* Applying the Act so as to revive Plaintiffs' claims necessarily would "alter the substantive rights" of the parties and create a "new, private right of action." *Id.* Section 804(c) of the Act, however, expressly forbids that result. Plaintiffs' claims are time-barred and should be dismissed.

2. The Language of the Act Does Not Clearly Express Any Intent to Revive Formerly Time-Barred Claims.

Even apart from the clear language of Section 804(c), the Act cannot be construed to revive previously time-barred claims.

The Fifth Circuit has held that a statute extending a limitations period will not be deemed to revive previously time-barred claims unless the statute expressly states an intent to do so. For example, in *FDIC v. Belli,* 981 F.2d 838, 842 (5th Cir. 1993), the Fifth Circuit addressed whether 12 U.S.C. § 1821(d)(14), part of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), applied retroactively to revive claims that were time-barred under federal law before FIRREA was enacted. The statute provided that the limitations period on a contract claim held by the FDIC as receiver for a federally-insured bank began to run either when the claim accrued or when the FDIC was appointed receiver, whichever was later.[6]

The Fifth Circuit rejected the FDIC's contention that the statute revived claims that had expired before FIRREA was enacted. The court noted the general rule that "[i]n the absence of evidence of a contrary legislative purpose, 'subsequent extensions of a statutory limitation period will not revive a claim previously barred.'" *Belli,* 981 F.2d at 842 (quoting *Village of Bellwood v. Dwivedi*, 895 F.2d 1521, 1527 (7th Cir. 1990)). The court held that the FIRREA provision before it "lacks a clearly expressed intent" to revive claims that had expired before its effective date, and thus should not be construed to revive such claims. *Id.* at 843.

Later, in *Resolution Trust Corp. v. Seale,* 13 F.3d 850 (5th Cir. 1994), the Fifth Circuit held that the same provision of FIRREA did not revive claims that were time-barred under state

[6] The statute provided: "Notwithstanding any provision of any contract, the applicable statute of limitations with regard to any action brought by the Corporation as conservator or receiver shall be -- ... (ii) in the case of any tort claim, . . . the longer of -- (I) the 3-year period of beginning on the date the claim accrued; or (II) the period applicable under State law.... *The date on which the statute of limitations begins to run on any claim described in such paragraph shall be the later of -- (i) the date of the appointment of the Corporation as conservator or receiver; or (ii) the date on which the cause of action accrues.*" 12 U.S.C. § 1821(d)(14)(A) & (B) (emphasis added).

law when FIRREA was enacted. *Id.* at 852-54. The court explained that *Belli* accommodates the competing policies at issue "by invoking the doctrine of clear statement -- Congress can revive stale claims but must do so clearly." *Id.* at 853. The court noted, citing *Belli,* that "[s]ubsequent extensions of a limitations period will not revive barred claims in the absence of a clear expression of contrary legislative intent." *Id.* The court held that neither the language nor the legislative history of FIRREA provided such a clear expression of an intent to revive time-barred claims. *Id.* at 853-54. *See also Hartford Cas. Ins. Co. v. FDIC*, 21 F.3d 696, 702 n.8 (5th Cir. 1994) ("In *Belli*, we stated that we would not revive a stale claim even where a statute of limitations had been extended.").

Section 804(b) of the Act does not come close to the "clear statement" required by the Fifth Circuit before a newly-extended limitations period will be held to revive formerly time-barred claims. On the contrary, the statute says nothing whatsoever about reviving time-barred claims. The language of the statute -- stating that the new limitations period applies only to proceedings "commenced on or after" the date the statute was enacted -- makes clear that Congress intended only to extend the statute for claims that were timely when the statute was enacted, and did not revive claims that were already barred.

Although the Fifth Circuit has not yet addressed this specific issue in the context of the Sarbanes-Oxley Act, the issue was squarely addressed in three district court cases in just the last year. In *In re Heritage Bond Litigation,* 289 F. Supp. 2d 1132 (C.D. Cal. 2003), plaintiffs alleged that certain officers and employees of a bankrupt brokerage firm failed to disclose that the proceeds of several bond offerings were being used for unauthorized purposes. Plaintiffs filed two separate complaints, one before and one after the Sarbanes-Oxley Act was signed into

law. The complaints were consolidated and defendants moved to dismiss on the basis that, among other things, plaintiffs' claims under Section 20(a) of the '34 Act were time barred.

The court held that plaintiffs' claims were already barred by the three-year statute of limitations when the Sarbanes-Oxley Act came into effect. Claims "which were time-barred as of July 30, 2002, the date of the Sarbanes-Oxley Act's enactment, cannot be revived by the amended statute of limitations." *Id.* at 1148. *Accord Glaser v. Enzo Biochem, Inc.*, __ F. Supp. 2d __, No. CIV.A. 02-1242-A, 2003 WL 21960613, at *5 (E.D. Va. July 16, 2003) ("While Congress may enlarge a limitations period, Congress' acts do not revive a cause of action that has become time-barred unless Congress specifically provides for retroactive application. . . . Congress did not unambiguously provide that the [Sarbanes-Oxley] two year limitations period would apply retroactively."); *In re Enterprise Mortgage Acceptance Co. Sec. Litig.*, __ F. Supp. 2d __, No. 1:03-CV-3752, 2003 WL 22955925, at *9 (S.D.N.Y. Nov. 14, 2003) ("[B]ecause the language and legislative history of the Sarbanes-Oxley act does not show Congress clearly intended to apply the lengthened statute of limitations in Section 804 to already time-barred claims, plaintiffs' claims are dismissed.").[7]

Had Congress intended to revive time-barred claims, it could readily have done so, as it has done in other federal statutes. *See Nehme* v. *INS*, 252 F.3d 415, 432 (5th Cir. 2001) ("In contrast to § 104, the effective date provisions contained in Title II explicitly provide that the amendments related to voting apply to past conduct and shall be effective as if they had been enacted in 1996. Had Congress intended that the amendments to § 320 of the INA have the broad retroactive effect Nehme advocates, it would have used similar retroactive language in

[7] The only contrary case, *Roberts* v. *Dean Witter Reynolds, Inc.*, No. 8:02-CV-2115-T-26EAJ, 2003 WL 1936116 (M.D. Fla. Mar. 31, 2003), is distinguished at length on pages 24 to 29 of Bank Defendants' Memorandum of Law in Support of Their Motion to Dismiss on Statute of Limitations Grounds, filed November 14, 2003 (filed under *Washington State Investment Board* caption, Docket No. 76). Rather than burden the Court with repetition of those arguments, RBSG incorporates those pages here.

§ 104."); *Resolution Trust Corp. v. Artley,* 28 F.3d 1099, 1103 n.6 (11th Cir. 1994) ("Congress is clearly aware of its ability to revive stale claims; and, if it wished, Congress could have provided a lengthy limitations period which explicitly revived stale claims . . . .").

The history of the FIRREA limitations period at issue in *Belli* and *Seale* shows that Congress is well aware of the "clear statement" requirement for reviving time-barred claims and of the language that can be used to satisfy it. In response to those decisions, Congress amended FIRREA to provide expressly that the time-barred claims were revived. *See Bank and Thrift Statute of Limitations Clarification Act of 1994: Statements on Introduced Bill and Joint Resolutions,* 103rd Cong., 2d Sess., 140 Cong. Rec. S 4347 (Comments of Senator Riegle) (April 14, 1994). The statute, as amended, provided:

> *Revival of expired state causes of action.* In the case of any tort claim described in subparagraph (A)(ii) *for which the statute of limitation applicable under State law with respect to such claim has expired* not more than 5 years before the appointment of the Corporation as a conservator or receiver, the Corporation may bring an action as conservator or receiver on such claim *without regard to the expiration of the statute of limitation* applicable under State law.

Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, § 201, 108 Stat. 2368 (1994) (emphasis added).

Here, in contrast, the statute says nothing to indicate an intent to revive previously time-barred claims or to apply the new statute of limitations to those claims. Absent that clear statement, the statute cannot be construed to revive time-barred claims.

3. The Legislative History of The Act Further Shows That Congress Did Not Intend To Revive Time-Barred Claims.

Consistent with the language of the statute, the legislative history contains nothing to suggest that Congress intended to revive claims that were already time-barred.[8] Nowhere in the Act's legislative history can one find any form of the words "retroactive," "retrospective," or "revival," or any statement that the new statute of limitations would revive time-barred claims.

Indeed, the legislative history expresses Congress' recognition that, even after the Act became law, previously time-barred claims would still be time-barred. For instance, Senator Patrick Leahy (a sponsor of the amendment to the Act that added Section 804(b)) stated in a Capitol Hill hearing held six days before the Act was signed by President Bush, "[In the Act] we extend the statute of limitations in security-fraud cases -- something that *would've helped* so many people who were defrauded by Enron and others." *Conference Report on Corporate Responsibility Legislation* (July 24, 2002), available at LEXIS, News Library, Federal News Service File (emphasis added). Senator Leahy also stated that "In Washington State alone, the short statute of limitations may cost [investors] . . . nearly $50 million in lost Enron investments *which they can never recover.*" *Legislative History of Title VIII of HR 2673: The Sarbanes Oxley Act of 2002*, 107th Cong., 2d Sess., 148 Cong. Rec. S 7418 (July 26, 2002) (emphasis added). These statements reflect Congress' clear understanding that the Act *will not* revive these expired claims.

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[8] Since *Landgraf v. USI Film Products*, 511 U.S. 244 (1994), the circuits have split on whether legislative history alone can ever satisfy the "clear intent" requirement. *See Hunter v. United States*, 101 F.3d 1565, 1569 (11th Cir. 1996) (*en banc*), *cert. denied sub nom. Nagle v. Bailey*, 520 U.S. 1211 (1997) (recognizing that "there appears to be a conflict among the circuits, and even within some circuits, about whether *Landgraf's* first step can be satisfied by evidence of legislative intent other than in an express statutory command"), *abrogated on other grounds*, *Lindh v. Murphy*, 521 U.S. 320 (1997). It appears that since *Landgraf*, the Fifth Circuit has never found that a statute applied retroactively solely based on legislative history. Thus, to find that a statute applies retroactively absent an unambiguous directive in the statute itself would represent a significant departure from Fifth Circuit precedent.

The same understanding was articulated by Senator Gramm in an exchange with Senator Durbin on the floor of the Senate on July 10, 2002. Senator Durbin stated that the then-current one-year/three-year limitations period allowed certain corporate officers to "get off the hook." Senator Gramm later responded: "When the Senator was talking about letting people off the hook, surely everybody understands that our system has no ex post facto laws. So, if the provision raising the statute of limitations to 5 years became law, *it would have no effect on anybody who has committed one of these violations about which we are talking.*" 107th Cong., 2d Sess., 148 Cong. Rec. S 6524, at 36-37 (July 10, 2002) (emphasis added). No Senator contradicted Senator Gramm or expressed a different understanding as to the applicability of the new limitations period.

Under *Lampf*, claims based on the Sutton Bridge and LJM1/Rhythms Hedge transactions were absolutely barred by the three-year statute of repose as of June 2002. The Sarbanes-Oxley Act, enacted on July 30, 2002, did not revive claims that were already time-barred at the time of its enactment. Plaintiffs' claims based on the Sutton Bridge and LJM1/Rhythms transactions are time-barred and must be dismissed.

B. PLAINTIFFS' CLAIMS WOULD BE BARRED BY THE TWO-YEAR SARBANES-OXLEY STATUTE OF LIMITATIONS.

Even if Sarbanes-Oxley's new two-year limitations period were applied to this proceeding, Plaintiffs' claims would nonetheless be time-barred. Enron's public announcements and SEC filings before December 2, 2001, put Plaintiffs on clear notice of the possibility of fraud.

1. Inquiry Notice Requires Only Knowledge of Facts That Would Prompt a Reasonable Person to Investigate.

The limitations period for federal securities law claims "commences when 'the aggrieved party has either knowledge of the violation or notice of facts which, in the exercise of due

diligence, would have led to actual knowledge' thereof." *Jensen v. Snellings*, 841 F.2d 600, 606 (5th Cir. 1988) (quoting *Davis v. A.G. Edwards & Sons, Inc.*, 823 F.2d 105, 107 (5th Cir. 1987)). "Investors are not free to ignore 'storm warnings' which would alert a reasonable investor to the possibility of fraudulent" conduct. *Id.* at 607. Instead, "[t]he requisite knowledge that a plaintiff must have to begin the running of the limitations period is merely that of the facts forming the basis of his cause of action, . . . not that of the existence of the cause of action itself." *Id.* (internal quotations and citation omitted). More specifically, the limitations period for

> "suits under Rule 10b-5 begins to run not when the fraud occurs, and not when the fraud is discovered, but when (often between the date of occurrence and the date of the discovery of the fraud) the plaintiff learns, or should have learned through the exercise of ordinary diligence in the protection of one's legal rights, *enough facts to enable him by such further investigation as the facts would induce in a reasonable person to file a lawsuit within one year.*"

Columbraria Ltd. v. Pimienta, 110 F. Supp. 2d 542, 548 (S.D. Tex. 2000) (quoting *Fujisawa Pharmaceutical Co. v. Kapoor*, 115 F.3d 1332, 1334 (7th Cir. 1997) (Posner, J.)) (emphasis added).

Complete knowledge of the nature or extent of the fraud is not necessary for inquiry notice. Instead, plaintiffs are on notice when they have "knowledge of facts that would lead a reasonable person to begin investigating the possibility that his legal rights had been infringed." *Theoharous v. Fong*, 256 F.3d 1219, 1228 (11th Cir. 2001). "Inquiry notice is triggered by evidence of the possibility of fraud, not full exposition of the scam itself." *Id. See also Sterlin v. Biomune Systems*, 154 F.3d 1191, 1204 (10th Cir. 1998) (for inquiry notice, information "need only alert a reasonable investor to the possibility of fraud"); *Dodds v. Cigna Securities, Inc.*, 12 F.3d 346, 352 (2d Cir. 1993) ("An investor does not have to have notice of the entire fraud being perpetrated to be on inquiry notice.").

Once a plaintiff is on notice of the possibility of a fraud, the statute of limitations period begins running as to all defendants who participated in that alleged fraud. For example, where the plaintiff alleged fraud by a company and its auditor in the sale of securities, the Seventh Circuit rejected the "misconception . . . that the period of limitations starts defendant-by-defendant, rather than injury-by-injury." *Whitlock Corp. v. Deloitte & Touche, L.L.P.*, 233 F.3d 1063, 1065 (7th Cir. 2000). The plaintiff argued that even though it had been aware of "chicanery . . . in the valuation of Whitlock's inventory" in April 1995, it did not know of the auditor's role in the fraud until later. *Id.* at 1065-66. The Seventh Circuit acknowledged that the plaintiff may not have learned of the auditor's role until later, but nonetheless held that "if Apex's claim accrued in April 1995, then time started running with respect to all potentially responsible persons." *Id.* at 1066 (citing cases). The plaintiff "could have used the ensuing years to determine who was to blame," and "it did not have to search hard to find Deloitte [the auditor]." *Id.* Accordingly, the court held the fraud claim against the auditor barred by the statute of limitations. *Id.*[9]

Similarly, in *LC Capital Partners, L.P. v. Frontier Insurance Group. Inc.*, 318 F.3d 148, 156 (2d Cir. 2003), the Second Circuit held that investor complaints against Frontier Insurance Group and Ernst & Young filed July 19, 2000, and February 5, 2001, respectively, were both time-barred. The plaintiffs alleged, among other things, that Frontier was deliberately pursuing policies that resulted in under-reserving Frontier's insurance claims. *Id.* Frontier had indeed taken a series of charges restating its reserves: "$17.5 million in 1994, $40 million in 1997, $139

[9] *See also LeBlang Motors, Ltd. v. Subaru of Am., Inc.*, 148 F.3d 680, 691 (7th Cir. 1998) ("LeBlang counters that even if its fraud action accrued against Subaru in mid-April 1990, it did not accrue against Wright and Knight until late 1995 or early 1996, when LeBlang learned that Wright and Knight were aware that the planning volume number supplied to LeBlang was overstated. . . . We hold that LeBlang's fraud action accrued against all potential defendants in mid-April 1990, when LeBlang learned that the planning volume number he was given was inflated. LeBlang's deposition testimony establishes that LeBlang believed at that time that he had been injured, and also believed that the injury was caused by a lie. . . . This is all that is required for the statute to begin running in Illinois." (internal footnotes and citations omitted)).

million in 1998, and $136 million in 1999." *Id.* at 151. The amended complaint alleged that Ernst & Young, as Frontier's auditor, had made materially misleading statements in its audits of the company. *Id.* The district court dismissed the complaints against both Frontier and Ernst & Young as time-barred.

On appeal, the Second Circuit "agree[d] with the District Court that the 'storm warnings' evident on the face of the detailed complaint and in related publicly available documents gave rise to a duty of inquiry no later than December 1998." *Id.* at 155. "The [District] Court determined that the Plaintiffs were on notice as to potential fraud by E & Y at the same time they were on notice as to Frontier." *Id.* at 153-54. As to Ernst & Young, the Second Circuit stated that "[a]ll of the storm warnings existing by December 1998 very likely render the claims against E & Y time-barred, as the District Court ruled, and, in any event, Frontier's fourth reserve charge -- $136 million in 1999 -- enhanced the duty of inquiry. The District Court correctly ruled that the corrected complaint, filed February 5, 2001, was time-barred as to E & Y." *Id.* at 156.

2. Plaintiffs Were on Notice of Violations Before December 2, 2001.

Plaintiffs were on notice of the facts constituting the alleged violations before December 2, 2001. Plaintiffs were put on inquiry notice on October 16, 2001, when Enron announced its $1 billion charge and $1.2 billion reduction in shareholder equity. Plaintiffs demonstrated their knowledge by filing the *Newby* complaint the following week, on October 22, 2001. Plaintiffs were given yet more knowledge on November 8, 2001, when Enron made detailed disclosures in public SEC filings of the specific transactions forming the basis of the claims against RBSG.

When evaluating the sufficiency of a complaint on a motion to dismiss, a court may consider not only the allegations in the complaint but also matters properly subject to judicial notice. *See Nathenson v. Zonagen Inc.*, 267 F.3d 400, 416 n.14, 417, 423 n.22 (5th Cir. 2001) (in reviewing dismissal under Rule 12(b)(6) of federal securities claims, considering SEC filings and

press release); *In re Capstead Mortg. Corp. Sec. Litig.*, 258 F. Supp. 2d 533, 543 n.2 (N.D. Tex. 2003) (in reviewing motion to dismiss, noting that court may take judicial notice of SEC filings, stock prices, and matters of public record); *Kramer v. Time Warner Inc.*, 937 F.2d 767, 774 (2d Cir. 1991) (taking judicial notice of SEC filings); *Ieradi v. Mylan Labs., Inc.*, 230 F.3d 594, 598 n.2 (3d Cir. 2000) (taking judicial notice of newspaper article).

Innumerable news reports in the months before Enron declared bankruptcy provided clear signals of possible financial fraud by Enron and targeted the role of off-balance-sheet partnerships, including LJM1, in that possible fraud.[10] News reports also predicted Enron's impending bankruptcy filing.[11] Plaintiffs themselves plead that on October 16, 2001, Enron "shocked the markets with revelations of $1.0 billion in charges and a reduction in shareholders' equity by $1.2 billion." (Am. Compl. ¶ 61.) The very next day, the Wall Street Journal identified "vexing conflict-of-interest questions . . . connected with a pair of limited partnerships [LJM1 and LJM2] that until recently were run by Enron's chief financial officer." John Emshwiller & Rebecca Smith, *Enron Jolt: Investments, Assets Generate Big Loss -- Part of Charge Tied To 2 Partnerships Interests*, Wall St. J., Oct. 17, 2001, at C1. The article noted that LJM1 and LJM2 "have engaged in billions of dollars of complex hedging transactions with Enron involving company assets and millions of shares of Enron stock," even though Enron's SEC filings do not make clear "what Enron received in return for providing these assets and shares." *Id.*

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[10] *See, e.g.*, Rebecca Smith & John R. Emshwiller, *SEC Seeks Information on Enron Dealings With Partnerships Recently Run by Fastow*, Wall St. J., Oct. 23, 2001, at A3; Simon London & Sheila McNulty, *Enron flickers: Once a paragon of the new economy, the US energy group is under scrutiny for its opaque accounting and free-wheeling management*, Financial Times (London), Oct. 29, 2001, at 22; John R. Emshwiller, *Enron Partnerships Led by Fastow Face a Formal SEC Investigation*, Wall St. J., Nov. 1, 2001, at A-4; Alex Berenson, *S.E.C. Opens Investigation Into Enron*, N.Y. Times, Nov. 1, 2001, at C-4; John R. Emshwiller *et al.*, *Partnership Dealings Cited as Dynegy Talks Go On; Debt Ratings an Issue*, Wall St. J., Nov. 9, 2001, at A3.

[11] *See* Rebecca Smith & John R. Emshwiller, *Running on Empty: Enron Faces Collapse As Credit, Stock Dive And Dynegy Bolts*, Wall St. J., Nov. 29, 2001, at A1; Peter Behr, *Deal to Take Over Enron Unravels; Once-Proud Energy Trading Firm Left Near Bankruptcy; Market Impact Feared*, Wash. Post, Nov. 29, 2001; Bill Deener,

The SEC soon commenced an investigation. (Am. Compl. ¶ 61.) In Enron's November 8, 2001 Form 8-K, Enron disclosed that a number of its related partnerships had not been accounted for correctly. *See* Form 8-K Current Report, Enron Corp. (Nov. 8, 2001), attached as Ex. D, at 1-4. Enron specifically discussed the LJM1/Rhythms Hedge transaction. *Id.* at 4-5, 10-11, 14-15. In the following weeks, "Enron's stock collapsed [and] its credit rating was downgraded to 'junk' . . . ." (Compl. ¶ 3.)

These public documents put Plaintiffs on inquiry notice not only of the facts suggesting fraud by Enron, but also of NatWest's involvement in the transactions now alleged to form the basis of Plaintiffs' claims against RBSG. Enron's dealings with LJM Cayman, L.P. ("LJM1") were disclosed by Enron in SEC filings as early as August 16, 1999. *See* Form 10-Q Quarterly Report, Enron Corp. (Aug. 16, 1999), attached as Ex. E, at Part I, Item 1, Note 8. In an August 8, 2000 SEC filing, Enron identified NatWest as a limited partner of LJM1: "To our knowledge, Greenwich NatWest and Credit Suisse collectively own a 94% interest in LJM Cayman, L.P., and an individual owns a 6% interest." Form U-57, Enron Corp. (Aug. 4, 2000), attached as Ex. F, at 2. Enron's August 16, 1999 filing had revealed that "[a] senior officer of Enron is managing member of LJM's general partner." Form 10-Q, Ex. E, at Part I, Item 1, Note 8.[12] Thus, since at least August 2000 NatWest's significant ownership interest in LJM1 was a matter of public record.

In a stock analyst report issued October 23, 2001, Lehman Brothers explained "the mechanics of what went wrong at LJM . . . ." Lehman Brothers, *Enron Corp: Stock Discounts*

(continued...)

Enron's dizzying spin down; Energy trader's shares fall 85% after credit gets junk rating; Bankruptcy filing might be Houston company's last refuge, Dallas Morning News, Nov. 29, 2001, at 1D.

[12] This sentence, disclosing Fastow's role in LJM1, was one of many details from Enron's regulatory filings that "raised multiple red flags" to James Chanos, a Wall Street short seller, as early as October 2000. Cassell Bryan-Low & Suzanne McGee, *Enron Short Seller Detected Red Flags in Regulatory Filings*, Wall St. J., Nov. 5, 2001, at C1.

the Worst, Oct. 23, 2001, attached as Ex. G. Even though "LJM was set up to hedge investments," the report explains that because LJM relied on Enron's own stock, the fall in Enron's stock left "the partnership with inadequate collateral to support the structure." *Id.* In other words, the report claims that the supposed LJM hedge was not really an effective hedge. This is the same claim made in Plaintiffs' 12/03 Complaint. By October 29, 2001, analysts opined that "[f]raud risk already appears to be discounted in Enron's share price," as investors "assume[] there are hidden further obligations . . . ." Bernstein Research Call, *Enron: Near Term Crisis Could Lead to Shell-Shock, by a Takeover*, Oct. 29, 2001, at 6, attached as Ex. H.

In Enron's November 8, 2001 Form 8-K, Enron pointed specifically to the facts now forming the basis of Plaintiffs' claims against RBSG. Form 8-K, Ex. D. Enron stated that it "believes that the LJM partnerships have as limited partners a significant number of institutions and other investors that are not related parties to Enron." *Id.* at 3. LJM1, among other entities, "did not meet certain accounting requirements and should have been consolidated." *Id.* In particular, "[t]he financial activities of a wholly-owned subsidiary of LJM1, which engaged in derivative market transactions with Enron to permit Enron to hedge market risks of an equity investment in Rhythms NetConnections, Inc., should have been consolidated into Enron's financial statements beginning in 1999." *Id.* at 4.[13] Table 1 of the Form 8-K indicated that the consolidation of the LJM1 subsidiary resulted in, among other things, a $103 million reduction in reported net income and a $222 million reduction in reported total assets. *Id.* at 4, Table 1. Enron explained that its "decision that the LJM1 subsidiary should be consolidated in 1999 and 2000 is based on Enron's current assessment that the subsidiary did not qualify for

[13] *See also* Jonathan Weil, *Auditor Could Face Scrutiny on Clarity of Financial Reports*, Wall St. J., Nov. 5, 2001, at C1 (Enron's SEC disclosures "show[] that Enron chose to use shares and options of its own stock as its chief hedging instrument, even though their price movements wouldn't appear to be directly related to the value of the investments Enron was trying to hedge. 'I don't see how that possibly hedges any of Enron's risks or assets,' [said Douglas Charmichael, an accounting professor at Baruch College in New York]. Indeed, the disclosures have

nonconsolidation treatment because of inadequate capitalization." *Id.* at 5. Enron concluded that "the hedging transactions in which Enron engaged with the LJM1 subsidiary (related to Enron's investment in the stock of Rhythms NetConnections, Inc.) should have been consolidated into Enron's financial statements for 1999 and 2000." *Id.*

From this information, it reasonably could be inferred that NatWest was a significant owner of LJM1 and had made a significant capital contribution to LJM1. In addition, it was apparent that Enron's consolidation of the LJM1/Rhythms Hedge was due to the fact that LJM1 was inadequately capitalized to justify nonconsolidation. These facts together would have put a reasonable investor on notice that LJM1's significant equity owners and capital contributors -- which consisted of a senior Enron officer, NatWest, and Credit Suisse -- may have had a role in the events that had come under scrutiny and were already giving rise to investor claims rooted in Enron's failure to consolidate in previous years.

Plaintiffs demonstrated their actual knowledge of allegedly fraudulent Enron financial statements by filing the *Newby* complaint in October 2001. By no later than November 8, 2001, Plaintiffs had or should have had "knowledge of facts that would lead a reasonable person to begin investigating the possibility that his legal rights had been infringed." *Theoharous*, 256 F.3d at 1228. Even applying the new two-year Sarbanes-Oxley statute of limitations, that limitations period expired in mid-October 2003 or, at the latest, on November 8, 2003, almost a month before Plaintiffs filed their claims against RBSG. Those claims should therefore be dismissed as time-barred.[14]

(continued...)

given rise to widespread speculation that Enron's actual purpose was to use its off-balance-sheet transactions to shift losses off its books to avoid running them through its income statement.").

[14] Plaintiffs' claims against RBSG should at the very least be dismissed without prejudice due to Plaintiffs' failure to adequately plead their compliance with the statute of limitations. Generally, "[t]he burden of proof as to the applicability or non-applicability of the statute of limitations is on the plaintiff in an action arising under the Securities Acts." 3C Harold S. Bloomenthal & Samuel Wolff, Sec. & Fed. Corp. Law § 17:35 (2d ed. 2001). *See*

III. PLAINTIFFS HAVE FAILED TO ALLEGE PRIMARY VIOLATIONS BY RBSG.

A. A PRIMARY VIOLATOR MUST ENGAGE IN ACTIVE CONDUCT THAT IS DECEPTIVE OR MANIPULATIVE.

The 12/03 Complaint must independently be dismissed because of the United States Supreme Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).[15] *Central Bank* makes clear that "[a]ny person," including a secondary actor, "who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met." *Id.* at 191. *Central Bank* dictates, however, that only conduct that is expressly prohibited by the text of Section 10(b) can violate Section 10(b) or Rule 10b-5. *Id.* at 177. "[T]he statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act. . . . We cannot amend the statute to create liability for acts that are not *themselves manipulative or deceptive* within the meaning of the statute." *Id.* at 177-78 (emphasis added); *see also Chiarella v. United States*, 445 U.S. 222, 234-35 (1980) ("Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud.").

(continued...)

also, e.g., Cook v. Avien, Inc., 573 F.2d 685, 695 (1st Cir. 1978) ("[T]he federal courts have placed the burden of proof on the plaintiffs when questions of limitations arise under § 10(b) once the defendant has pleaded the statute of limitations."). Here, Plaintiffs allege that violations occurred between June 1999 and June 2001, *see* part I.B above, which shows that the 12/03 Complaint was not filed within two years of the alleged violations. While the 12/03 Complaint alleges in a conclusory fashion that Plaintiffs "received notice of the conduct alleged herein by the public filing of the Final Report by Enron's Court-Appointed Examiner," (Compl. ¶ 4), this statement fails to plead with the required particularity the reasons why Plaintiffs were not on notice before December 2, 2001.

[15] In this Court's December 20 Order, the Court rejected the "bright line" test for Section 10(b) and Rule 10b-5 liability articulated in cases such as *Ziemba v. Cascade Int'l Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001), *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998), and *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1226 (10th Cir. 1996). With all due respect, RBSG agrees with the other bank defendants that the "bright line" test is the appropriate standard for Section 10(b) and Rule 10b-5 liability, *i.e.*, that "a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b)." *Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997). Under the "bright line" test, the 12/03 Complaint, which does not allege that RBSG actually made any false or misleading statements, must be dismissed. Given the Court's rejection of the "bright line" test in its December 20, 2002 Order, RBSG asserts this argument without further elaboration simply to protect the record.

In the key cases discussed by the Court in its December 20, 2002 Order, primary liability was found only where the defendant itself was alleged to have engaged in a "manipulative or deceptive device or contrivance." 15 U.S.C. § 78j(b). In *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 153 (1972), the defendant bank employees undertook a duty to the shareholders, and therefore acted deceptively by inducing the shareholders to sell their stock without disclosing that the bank was acting as a market maker and stood to gain financially. *Cf. Chiarella*, 445 U.S. at 230 (explaining that, in *Affiliated Ute*, "no duty of disclosure would exist if the bank merely had acted as a transfer agent"). In *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 9 (1971), the seller of bonds "was duped into believing that it, the seller, would receive the proceeds," but instead the defendants misappropriated the proceeds. Similarly, in *SEC v. Zandford*, 535 U.S. 813, 815 (2002), a broker with management discretion over a securities account allegedly engaged in deceptive conduct by engaging in unauthorized sales for his own benefit without disclosure to his customer. In *SEC v. U.S. Environmental, Inc.*, 155 F.3d 107, 112 (2d Cir. 1998), the defendant "effect[ed] the very buy and sell orders that artificially manipulated USE's stock price upward." In *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1997), the defendant itself made misleading statements to analysts with the intent that the analysts communicate those statements to the market. In *In re Blech Securities Litigation*, 961 F. Supp. 569, 584 (S.D.N.Y. 1997), the court held that "[t]he act of clearing sham trades alone, even with scienter, is not enough" to constitute primary liability; the complaint stated a claim only insofar as it alleged that the defendant not only cleared the trades, but also "directed" or "contrived" certain allegedly fraudulent trades.

By contrast, where the defendant's conduct does not itself involve "some element of deception," courts have found no primary liability. *See Santa Fe Indus. v. Green*, 430 U.S. 462,

475 (1977) (allegations of fiduciary breach without material misrepresentation, failure to disclose, or manipulative conduct did not state a claim for violation of Section 10(b) or Rule 10b-5); *GFL Advantage Fund, Ltd. v. Colkitt*, 272 F.3d 189, 207 (3d Cir. 2001) (lawful short selling did not constitute market manipulation because it did not involve "injecting false inaccurate information into the marketplace or creating a false impression of supply and demand for the stock"), *cert. denied*, 536 U.S. 923 (2002); *In re Splash Tech. Holdings, Inc. Sec. Litig.*, No. C 99-00109 SBA, 2000 WL 1727377, at *19-20 (N.D. Cal. Sept. 29, 2000) (defendants not primarily liable where they did not make a misleading statement and where plaintiffs failed to allege adequately that defendants engaged in manipulative or deceptive insider trading); *Advanced Laser Prods., Inc. v. Signature Stock Transfer, Inc.*, No. Civ. A. 3:98-CV-1624-D, 1999 WL 222385, at *2 (N.D. Tex. Apr. 12, 1999) (defendants alleged to have "fenced" stolen securities were not primarily liable because "the acts on which [plaintiff] bases the claims do not involve the element of deception by [defendant]. Deception is required to state a cause of action under § 10(b) and Rule 10b-5.").

In the December 20 Order, this Court recognized that primary liability can lie only where the defendant engaged in an act (whether in the form of a misrepresentation or other device, scheme, artifice, act, or practice that operates as a fraud) that itself deceives investors. The Court stated, for instance, that a complaint alleging "scheme" liability against a group of defendants is sufficient only "as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme." December 20 Order at 58-59 (quoting *Cooper*, 137 F.3d at 624); *see also* December 20 Order at 272-73 ("any Defendant that *itself* with the requisite scienter, *actively employed* a significant material device, contrivance, scheme, or artifice to defraud or *actively engaged* in a significant, material act, practice, or course of business that operated as a fraud or

deceit upon any person in connection with the purchase or sale of any security may be primarily liable") (emphasis added). *Accord In re Homestore.com, Inc. Sec. Litig.*, 252 F. Supp. 2d 1018, 1040 (C.D. Cal. 2003) ("Those who actually 'employ' the scheme to defraud investors are primary violators, while those who merely participate in or facilitate the scheme are secondary violators.").[16]

Similarly, in accepting the SEC's test for primary liability, the Court recognized that "a person who prepares a truthful and complete portion of a document," "[e]ven assuming such a person knew of misrepresentations elsewhere in the document," "would not be liable as a primary violator." December 20 Order at 52 (quoting SEC *amicus* brief). That, of course, is because the deception is the product not of the person's own draftsmanship, but of the draftsmanship or statements of others. Analogously, a person who does not himself engage in a manipulative or deceptive act cannot be liable as a primary violator, even if he knows that his lawful act was part of a scheme to defraud employed by another person.

As the December 20 Order itself noted, "scienter [is] a separate issue and not relevant to" the question of whether a defendant is a primary violator or merely an aider and abettor. December 20 Order at 60 (citing *SEC v. U.S. Envtl.*). "[W]hether [a defendant] was a primary violator rather than an aider and abettor turns on the nature of his acts, not on his state of mind when he performed them." *U.S. Envtl.*, 155 F.3d at 111.

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[16] Elsewhere, the December 20 Order stated that primary liability may be found when a defendant has merely "participated" in a scheme to defraud, whether or not the conduct allegedly engaged in by the defendant was itself manipulative or deceptive. December 20 Order at 30; *see also id.* at 276. Indeed, the December 20 Order stated that once a party engages in any prohibited conduct with scienter, "*any alleged subsequent activity* by that party," including even silence, "necessarily becomes suspect as further *complicity in*, expansion of, and perpetuation of the alleged Ponzi scheme." *Id.* at 277 (emphasis added). If this language were applied literally, it would misstate the law following *Central Bank*. *See Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997) ("Allegations of 'assisting,' 'participating in,' 'complicity in' and similar synonyms used throughout the complaint all fall within the prohibitive bar of *Central Bank*."). We do not understand that the Court's use of ambiguous language at several points in the December 20 Order was intended to announce a standard at odds with the law described above.

B. RBSG'S ALLEGED CONDUCT WAS PASSIVE, NOT ACTIVE.

1. RBSG Is Alleged to Have Played Only a Passive Role In The Sutton Bridge, Nixon Prepay, and ETOL I, II and III Transactions.

Plaintiffs' allegations relating to the Sutton Bridge, Nixon Prepay, and ETOL I, II and III transactions characterize RBSG's participation in these transactions as that of a passive, commercial partner. Enron proposed these transactions to RBSG; there are no allegations that RBSG designed, controlled, structured or directed these transactions. Accordingly, the 12/03 Complaint fails to allege that RBSG is a primary violator as to these transactions, because it does not plead that RBSG "*actively employed* a significant material device, contrivance, scheme, or artifice to defraud or *actively engaged* in a significant, material act, practice, or course of business that operated as a fraud or deceit upon any person in connection with the purchase or sale of any security . . . ." December 20 Order at 272-73 (emphasis added).

2. RBSG Is Alleged to Have Played Only a Passive Role In The LJM1/Rhythms Hedge Transactions.

The allegations relating to the alleged non-economic hedging of Rhythms NetConnections stock similarly characterize RBSG's participation as that of a passive, commercial partner. The 12/03 Complaint pleads only that RBSG provided a capital investment in LJM1, and that LJM1 was then used by Fastow and Enron to hedge Enron's Rhythms investment. (Compl. ¶ 25.) That Complaint alleges that the hedge failed to transfer the risk of the Rhythms stock away from Enron, and that Enron's accounting for the transaction was therefore misleading. (Compl. ¶ 31 & App. E, at 31-32.) The 12/03 Complaint does not allege that RBSG played any role in structuring or directing the Rhythms Hedge, or in preparing or disseminating the allegedly improper statements accounting for that hedge. The 12/03 Complaint thus does not allege that RBSG "*actively employed* a significant material device, contrivance, scheme, or artifice to defraud or *actively engaged* in a significant, material act,

practice, or course of business that operated as a fraud or deceit upon any person in connection with the purchase or sale of any security . . . ." December 20 Order at 272-73 (emphasis added).[17]

C. RBSG'S ALLEGED CONDUCT WAS NOT MANIPULATIVE OR DECEPTIVE.

Beyond its passive role, RBSG is not alleged to have engaged in any manipulative or deceptive conduct that deceived or misled investors. Rather, the most that is alleged is that RBSG engaged in transactions with Enron that were later misrepresented *by Enron* in its financial statements.[18] There is nothing inherently fraudulent or wrongful about the alleged transactions; any impropriety is a result only of Enron's alleged failure to account for the transactions properly. RBSG's roles in these transactions do not constitute "manipulative" conduct because, as this Court has acknowledged, "manipulation" is "virtually a term of art when used in connection with securities markets and refers to practices such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." December 20 Order at 11 n.8 (internal quotation marks omitted; quoting *Santa Fe Indus.*, 430 U.S. at 476); *see also Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1360 (N.D. Tex. 1979) (manipulative devices are "practices in the marketplace which have the

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[17] Apart from RBSG's purely passive role in the Rhythms Hedge, Plaintiffs plead that RBSG participated in other LJM1 transactions that resulted in Fastow being enriched from the value of the Enron stock, in violation of his fiduciary duties to Enron and the restrictions put in place by the Enron Board. (*See generally* Compl. ¶¶ 27-31 & App. E, at 29, 32-62.) These allegations have nothing to do with the alleged securities violations. Transactions involving LJM1 in which Fastow enriched himself and others, allegedly in an improper manner, did not mislead or deceive investors or enable Enron to misrepresent its financial status. Any such transactions were not practices "intended to mislead investors by artificially affecting market activity." December 20 Order at 12 n.8 (internal quotation marks omitted; quoting *Santa Fe Indus.*, 430 U.S. at 476). Nor did they "have the effect of either creating the false impression that certain market activity is occurring when in fact such activity is unrelated to actual supply and demand or tampering with the price itself." *Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1360 (N.D. Tex. 1979). In short, these transactions had no effect (and are not alleged to have had any effect) on the market for Enron securities, and they are irrelevant to Plaintiffs' securities claims.

[18] The 12/03 Complaint alleges, in passing, that RBSG "made or participated in the making of false and misleading statements . . . ." (Compl. ¶ 2.) To the extent this clause of the 12/03 Complaint purports to allege a claim based on a theory of actually making misleading statements, that claim must be dismissed for failure to plead with particularity.

effect of either creating the false impression that certain market activity is occurring when in fact such activity is unrelated to actual supply and demand or tampering with the price itself").

In the key cases discussed above at pages 22 to 23, where primary liability was found, the schemes or devices involved were in and of themselves manipulative. No second step was necessary; the activities *themselves* deceived the market. This factor is critical in establishing Section 10(b) liability. The Supreme Court emphatically underscored just this point in *Central Bank*, emphasizing that there is *no* Section 10(b) liability "for acts that are not *themselves* manipulative or deceptive within the meaning of the statute." 511 U.S. at 177-78 (emphasis added). Primary liability is imposed only on the person or entity that actually engaged in the manipulative or deceptive act.

By contrast, none of the transactions alleged here directly affected the market for Enron securities. The "deception" did not occur until Enron allegedly misreported them. There is no allegation, nor could there be, that the transactions themselves -- as opposed to Enron's disclosures -- deceived any investor. Had Enron properly accounted for the transactions (assuming that it did not), there would have been no fraud at all. Unlike the example used by the Court and the SEC (where a person "creates" a misrepresentation that is issued by another), RBSG is not alleged to have created, drafted, reviewed, advised on, authorized, or approved the accounting treatment or disclosure of the transactions in Enron's financial statements. RBSG is not alleged to have "directed" or "contrived" any misleading or deceptive transactions, or in any way to have caused Enron to enter into or misrepresent the transactions. *Cf. Blech*, 961 F. Supp. at 584. Even assuming that the transactions were used by Enron solely for the purpose of fraudulently inflating Enron's financial results, participation in the transactions as a counterparty to Enron -- without any affirmative act by RBSG to deceive investors -- is not a violation of

Section 10(b) and Rule 10b-5. Any "deception" of the market was the act of Enron, not of RBSG.

In re Homestore.com, Inc. Securities Litigation, 252 F. Supp. 2d 1018 (C.D. Cal. 2003), is directly on point. There, several "business partners" and "third party vendors" of Homestore.com, including AOL Time Warner, were alleged to have engaged in "barter transactions," "buying revenues," and "triangular transactions" or "round-tripping" with Homestore that created revenue for Homestore and enabled it to meet its revenue targets. *Id.* at 1022-26. The court discussed *Central Bank* at length, and dismissed the Section 10(b) and Rule 10b-5 claims against these secondary actors. The court based its decision on three grounds:

> First, the parties have not cited, and the Court is unaware of, any post-*Central Bank* case that has ever held that a simple business partner to a corporation is liable to the shareholders of that corporation for securities fraud. The Court declines the invitation to be the first. Second, no matter how a "scheme" is defined, *Central Bank* dictates that only those participants who commit "primary violations" of the securities laws may be held liable; those who merely facilitate or participate cannot. Third, in this case, the shareholders of Homestore were damaged by their reliance on statements and material omissions made by Homestore, not the "scheme" itself.

Id. at 1037-38.

The court then elaborated on each of its reasons. First, with respect to claims against an "outsider":

> [T]he Court is unaware of any case since *Central Bank* that has ever held that outside business partners, no matter how involved they were in fraudulent transactions with a corporation, can be held liable in a private action brought by the shareholders of that company. . . .
>
> [P]ersons "outside" a corporation have been held liable as primary violators in private actions brought by shareholders of that corporation if those persons substantially and directly participated in the creation of false or misleading statements to the investing public . . . . [I]n every post-*Central Bank* case cited to the Court where an "outsider" has been held liable as a primary violator, that outsider had some type of special relationship with the corporation, *i.e.*, accountant, auditor, etc. . . .

> [T]he language of the Supreme Court [in *Central Bank*] does not suggest, and the subsequent case law does not support, the notion that a business partner with no special relationship with a corporation, let alone its shareholders, can be held liable for the material misstatements or omissions of that corporation or its officers, no matter how much it assisted or participated in transactions that led to that statement or omission. Such a holding would broaden the scope of the securities acts so as to haul into court anyone doing business with a publically [*sic*] traded company.

Id. at 1038-39 (citations omitted).

Second, with respect to the definition of a primary violator after *Central Bank*:

> *Central Bank* requires a plaintiff to allege that each and every defendant committed its own independent primary violation of securities laws in order to state a claim. . . . [O]f the many participants in a "scheme," there may be primary violators and secondary violators. Those who actually "employ" the scheme to defraud investors are primary violators, while those who merely participate in or facilitate the scheme are secondary violators. In the present case, the primary architects of the scheme are the officers of Homestore who designed and carried out the schemes to defraud. The Court holds that other actors, such as AOL and its employees who actively participated in the triangular transaction scheme, did not "employ" the scheme to defraud investors, and are therefore secondary violators. Therefore, they are "aiders and abettors" within the meaning of *Central Bank*.

Id. at 1040 (citation omitted).

Finally, the court addressed the fact that Section 10(b) and Rule 10b-5 extend to conduct beyond the making of a material misstatement or omission:

> It is true that no "statement" is required to state a claim under Rule 10b-5 *in general*. For example, a person may be liable for a manipulative "act" or deceptive scheme that operates a fraud on another with respect to the purchase or sale of a security. *SEC v. Zandford*, 535 U.S. 813 . . . (2002) (broker held liable for conversion of securities from elderly person). In addition, a person may be held liable under Rule 10b-5 for insider trading, which has been considered a deceptive "device." *No. 84 Employer-Teamster v. America West*, 320 F.3d [920,] 937 [(9th Cir. 2003)]. However, in each of these examples, *it was the act or device that actually causes the damage to the injured party.*
>
> In the present case, plaintiff suffered damage through its reliance on false or misleading statements, not from the "scheme" itself. Thus, the scheme is one step removed from the injured party. *The scheme was not complete until the statement was made*. Essentially what plaintiff alleges is a scheme to make a deceptive statement or material omission. Yet the principal "wrong" alleged

> under the rule is the statement, not the scheme. Therefore, it is appropriate to require defendants in this case to be connected in some material way to the drafting of the statements made to the investing public. Here, this means the SEC filings, the press releases, the oral statements of Homestore, and the supporting statements of its auditor, Pricewaterhouse Coopers. Because plaintiff did not (and cannot) sufficiently allege that any of the business partner or third party vendor defendants substantially contributed to those statements, it cannot state a claim against those defendants for damages resulting from reliance on statements or material omissions.

Id. at 1040-41(second and third emphases added).

Here, RBSG's alleged role in connection with the Sutton Bridge, LJM1/Rhythms Hedge, Nixon Prepay, and ETOL I, II and III transactions is analogous to the role of AOL and the business partner and third party vendor defendants in *Homestore*. RBSG had no special relationship with Enron or its shareholders in connection with these transactions; RBSG was simply a third party that happened to do business with Enron -- much to its regret, it now turns out, RBSG having been deceived into multiple large credit relationships that now make it one of Enron's biggest Chapter 11 claimants. To the extent there was a scheme to defraud, the scheme was dependent on Enron's conduct in (allegedly) accounting for the transactions improperly and including this improper accounting in its publicly issued financial statements. Enron allegedly designed the transactions, employed the scheme, and created and disseminated the misstatements; even on the darkest, most one-sided view, RBSG could, at most, be accused of participating in or facilitating Enron's scheme. The transactions themselves were not fraudulent or illegal, and the only deceptive aspect of the scheme was the allegedly misleading accounting in Enron's financial statements. As in *Homestore*, RBSG's conduct was "one step removed" from the fraudulent statements that allegedly caused Plaintiffs' injury. Plaintiffs do not and cannot allege that RBSG contributed to those statements.

Accordingly, because there are no allegations in the 12/03 Complaint that would support a finding of a primary violation of Section 10(b) or Rule 10b-5 by RBSG, the Court should grant RBSG's motion to dismiss the 12/03 Complaint with prejudice.

IV. PLAINTIFFS FAIL TO ALLEGE LOSS CAUSATION AGAINST RBSG.

Plaintiffs must claim that the transactions constituting the alleged violations were not known until on or after December 2, 2001; otherwise, their claims are time-barred even under Sarbanes-Oxley's two-year statute of limitations. If none of these transactions were known before December 2, 2001, however, then none of the transactions could have caused Plaintiffs' investment losses: Plaintiffs' putative class period ended *before* the alleged fraud was disclosed. Plaintiffs cannot have it both ways. Either the information regarding these transactions was disclosed before December 2, 2001 -- in which case the alleged violations could have contributed to Plaintiffs' losses, but the two-year statute of limitations has run -- or else the information regarding these transaction was not disclosed before December 2, 2001 -- in which case Plaintiffs' claims might not be time-barred, but the transactions had nothing to do with Plaintiffs' investment losses.

Accordingly, to the extent that the information regarding the transactions allegedly resulting in misleading financial disclosures was not known publicly before December 2, 2001, Plaintiffs' claims against RBSG must be dismissed for failure to plead that any losses they have suffered were caused by RBSG's alleged conduct. If the Sutton Bridge, LJM1/Rhythms, Nixon Prepay, and ETOL I, II and III transactions did not become publicly known until after the putative class period ended on November 27, 2001, then Plaintiffs' losses could not have resulted from those alleged violations.

Loss causation is an essential element of a claim under Section 10(b) and Rule 10b-5. *See* 15 U.S.C. § 78u-4(b)(4). The Fifth Circuit articulated the loss causation requirement in

Huddleston v. Herman & MacLean, 640 F.2d 534 (5th Cir. 1981), *aff'd in part, rev'd in part on other grounds*, 459 U.S. 375 (1983):

> Causation requires one further step in the analysis: even if the investor would not otherwise have acted, was the misrepresented fact a proximate cause of the loss? . . . The plaintiff must prove not only that, had he known the truth, he would not have acted, but in addition that the untruth was in some reasonably direct, or proximate, way responsible for his loss. The causation requirement is satisfied in a Rule 10b-5 case only if the misrepresentation touches on the reasons for the investment's decline in value. If the investment decision is induced by misstatements or omissions that are material and that were relied on by the claimant, but are not the proximate reason for his pecuniary loss, recovery under the Rule is not permitted. *See Marbury Management, Inc. v. Kohn*, 629 F.2d 705, 718 (2d Cir. 1980) (Meskill, J., dissenting). Absent the requirement of causation, Rule 10b-5 would become an insurance plan for the cost of every security purchased in reliance upon a material misstatement or omission.

640 F.2d at 549 (citation and footnote omitted.)

Allegations that the price of a company's stock was artificially inflated due to the fraudulent conduct of the defendants are not sufficient to satisfy the requirement of loss causation. *Robbins v. Koger Props., Inc.*, 116 F.3d 1441, 1447-48 (11th Cir. 1997). Rather, plaintiffs show loss causation only if they demonstrate that "this price inflation was removed from the market price of [the company's] stock, causing plaintiffs a loss." *Id.* at 1448. In *Robbins*, a group of investors brought suit under Section 10(b) and Rule 10b-5 against Koger Properties, Inc., its officers, and its independent accounting firm when the price of Koger's stock dropped following a dividend cut. *See id.* at 1445. At trial, the plaintiffs presented evidence that the accounting firm had made fraudulent statements that had inflated the price at which they purchased Koger's stock, but the alleged fraudulent statements had not been discovered until more than one year after the drop in stock price. *See id.* at 1445-46. The district court denied the accounting firm's motion for judgment as a matter of law on loss causation, but the Eleventh Circuit reversed. The Eleventh Circuit, citing *Huddleston*, held that the investors had failed to satisfy the loss causation requirement because they did not present evidence that the artificial

inflation allegedly caused by the accounting firm was removed from the market price of Koger's stock, thereby causing a loss. *See id.* at 1448-49. *See also In re IKON Office Solutions, Inc. Sec. Litig.*, 131 F. Supp. 2d 680, 687 (E.D. Pa. 2001) (loss causation not shown where "stock price never dropped in response to disclosure of the alleged misrepresentations" (quotations omitted)).

While *Robbins* was decided following a trial, courts have also dismissed complaints on motions to dismiss for failure to plead loss causation. *See In re Equimed, Inc.*, No. 98-CV-5374, 2000 WL 562909, at *8 (E.D. Pa. May 9, 2000) (dismissing Rule 10b-5 claim for failure to plead loss causation because plaintiffs "do not allege that filing that action or public disclosure of the fraud caused the price to drop within the class period."); *D.E. & J Ltd. P'ship v. Conaway*, 284 F. Supp. 2d 719, 749 (E.D. Mich. 2003) (granting motion to dismiss where plaintiffs "have not alleged in their Complaint the requisite 'causal nexus' between the alleged misrepresentations of Defendants and the economic harm they suffered," but merely alleged that they "purchased a stock at a price that was artificially inflated by Defendants' misrepresentations."); *In re Cybershop.com Sec. Litig.*, 189 F. Supp. 2d 214, 233 (D.N.J. 2002) (granting motion to dismiss where "[t]he stock price did not drop after investors first received notice" of the allegedly omitted information); *Bastian v. Petren Resources Corp.*, 681 F. Supp. 530, 536 (N.D. Ill. 1988) (granting motion to dismiss where "[p]laintiffs . . . have not even attempted to plead that the information defendants allegedly omitted from the Offering Memoranda caused the decline in their . . . partnerships interest. . . . [T]he investments may be worthless for reasons completely unrelated to the non-disclosures; in that case, an amended complaint would not only fail, but might be subject to sanctions.").

Here, all that Plaintiffs have pled is that the market price of Enron securities was "artificially and falsely inflated by defendants' wrongful scheme." (Compl. ¶ 47.) As *Robbins*

makes clear, however, this contention is insufficient to show loss causation. Nowhere do Plaintiffs allege that RBSG's alleged conduct caused them any pecuniary loss. Instead, Plaintiffs claim that "Enron's stock collapsed" following Enron's announcement of a restatement of its financial results in October and November 2001, the subsequent downgrade of Enron's credit rating, and Enron's filing for bankruptcy protection. (Compl. ¶ 3.) Plaintiffs have not pled that RBSG's conduct is "in some reasonably direct, or proximate, way responsible for [their] loss." *Huddleston*, 640 F.2d at 549.

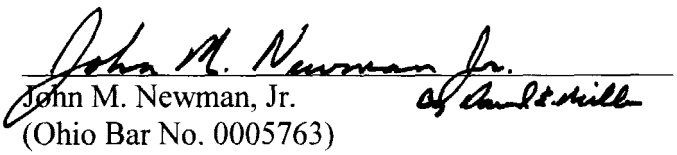
Plaintiffs' claims against RBSG should be dismissed for failure to plead loss causation.

V. CONCLUSION

For these reasons, Plaintiffs' claims against RBSG must be dismissed.

Dated: February 3, 2004

Respectfully submitted,



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CERTIFICATE OF SERVICE

I certify that a true and correct copy of the foregoing document has been served upon all counsel of record by sending a copy to the www.esl3624.com website on this 3rd day of February 2004.

John M. Newman, Jr.

John M. Newman, Jr. by David S. Miller

The Exhibit(s) May

Be Viewed in the

Office of the Clerk